

Legislative Analysis



MICHIGAN INNOVATION FUND

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<http://www.house.mi.gov/hfa>

House Bill 5651 (H-1) as reported from committee
Sponsor: Rep. Greg VanWoerkom

Analysis available at
<http://www.legislature.mi.gov>

House Bill 5652 (proposed substitute H-2)
Sponsor: Rep. Jason Hoskins

House Bill 5653 (proposed substitute H-5)
Sponsor: Rep. Alabas A. Farhat

Committee: Economic Development and Small Business
Complete to 11-13-24

BRIEF SUMMARY: Together, House Bills 5651, 5652, and 5653 would establish the Michigan Innovation Fund, a program that would provide grants to certain venture capital funds and nonprofits to promote venture capital investment. House Bills 5652 and House Bill 5653 would amend the Michigan Early Stage Venture Investment Act and the Michigan Strategic Fund Act, respectively, to create the program and provide for its funding through the Michigan Early Stage Venture Investment Fund (known as the Venture Michigan Fund). House Bill 5651 is a companion bill that would make complementary changes to the Michigan Trust Fund Act.

FISCAL IMPACT: The bills would authorize realized investment returns in investment funds of the Michigan Early State Venture Investment program to be utilized earlier than they otherwise would have been under current law. See *Fiscal Information*, below, for further discussion.

THE APPARENT PROBLEM:

According to committee testimony, entrepreneurship in Michigan is hindered by a lack of access to early-stage capital for startups, and many believe that Michigan is far behind other states when it comes to support for early-stage businesses. Reportedly, very few funds exist that can take the risk on a new business to help it gain traction, so entrepreneurs feel pressured to move elsewhere to start their businesses for better access to capital. Legislation has been proposed to address this funding gap and encourage entrepreneurs to start and grow their businesses in Michigan.

THE CONTENT OF THE BILLS:

House Bill 5652 would amend the Michigan Early Stage Venture Investment Act to extend the Michigan Early Stage Venture Investment program and to require \$60.0 million from the program's investment funds to be deposited into the 21st Century Jobs Trust Fund, which would be used for the Michigan Innovation Fund program that would be established by House Bill 5653. The remainder of returns would be distributed into the general fund.

The Michigan Early Stage Venture Investment Act established the Michigan Early Stage Venture Investment Corporation (MESVIC) and authorized the MESVIC to create a Michigan Early Stage Venture Investment Fund (known as the Venture Michigan Fund, or VMF, which

comprises the Venture Michigan Fund I and the Venture Michigan Fund II) to invest in Michigan startups.

Because of changes made to the act in 2015, the Michigan Early Stage Venture Investment Corporation currently cannot enter into any new agreements with investors, and the Michigan Early Stage Venture Investment Fund is set to expire on January 1, 2030. Upon expiration, subject to any outstanding debts and obligations, \$140.0 million from the fund must be deposited in the general fund, and the remaining money must be deposited in the 21st Century Jobs Trust Fund. Upon the MESVIC's dissolution, the first \$140.0 million of its property must go to the general fund, with the remainder going to the 21st Century Jobs Trust Fund.

House Bill 5652 would instead require the MESVIC board of directors to determine the investment fund's expiration date, which would have to be after January 1, 2030. All money remaining in the fund and other property upon expiration would be deposited into the general fund.

If the MESVIC has one or more investment funds with realized earned returns on investments as of June 30, 2024, the corporation's board would have to enter into an agreement with the Department of Treasury to distribute \$60.0 million of the earned returns to the state treasurer for deposit in the 21st Century Jobs Trust Fund and to distribute the remainder of the returns into the general fund. For each following year, if the MESVIC has one or more funds with realized annual returns as of June 30 of that year, those returns (as of June 30) would have to be distributed to the state treasurer to be deposited in the general fund.

The bill would also amend the act's requirements for a MESVIC's articles of incorporation to reflect these changes.

MCL 125.2237 et seq.

House Bill 5653 would add a new section to the Michigan Strategic Fund Act to create the "Michigan Innovation Fund" program, which would be administered by the Michigan Strategic Fund (MSF) to provide grants to certain venture capital funds and nonprofits. The bill would also modify the current Venture Capital Investment Program.

Michigan Innovation Fund

The bill would authorize the MSF to create and spend or invest money for the Michigan Innovation Fund program for the stated public purpose of encouraging economic development and job creation in Michigan. The program would provide grant support for ***qualified evergreen venture funds, qualified venture capital funds, qualified emerging evergreen funds, and qualified start-up support services*** in Michigan and would fund investments made through the Jobs for Michigan Investment Fund, and grants would have to be awarded to all eligible applicants. The Michigan Innovation Fund, and other programs under Chapter 8A of the act, would be operated and administered by the authorized officers, employees, and agents of the MSF, including the Michigan Economic Development Corporation (MEDC) and its employees.

Qualified evergreen venture fund would mean a tax-exempt ***qualified higher education institution*** or Michigan nonprofit corporation that administers, manages, or operates one or more ***evergreen funds***, if at least one of those funds provides early-

stage venture capital funding to entities in Michigan, has been actively operating in Michigan for at least three years, has at least four years of experience in making early-stage venture capital investments and in mentoring start-up companies, and has at least \$15.0 million in deployable capital or investments before January 1, 2024.

Qualified higher education institution would generally mean a state institution of higher education. It would also include a Michigan nonprofit corporation with the word “foundation” in its name that is incorporated under the Nonprofit Corporation Act for the purpose of supporting the objects and purposes of the University of Michigan, Michigan State University, or Wayne State University and for the purpose of assisting in that university’s educational purposes in an exclusively charitable manner,¹ in addition to a Michigan corporation incorporated under the Business Corporation Act for which a state institution of higher education is the only shareholder and whose name includes the words “biosciences” and “research.”²

Evergreen fund would mean either of the following:

- An investment plan or program of a Michigan nonprofit corporation that is exempt from taxation under section 501(c)(6) of the federal Internal Revenue Code.
- An investment fund organized for the purpose of investing in private debt or equity that has limited restrictions on or no provision for investor withdrawal and redemption rights, that operates on an open-end basis without a definitive closing date or fixed end date, and that allows capital to be raised on an ongoing basis and for the reinvestment of returns.

Qualified venture capital fund is defined under the act as a firm principally or primarily engaged in investing or acquiring early-stage businesses with growth potential that have not yet demonstrated consistent profitability or a proven business model, that is managed by two or more individuals with not less than five years of direct experience in venture capital, and that holds capital from investors other than the MSF.

Qualified emerging evergreen fund would mean any of the following:

- A public institution of higher education or a Michigan nonprofit that is exempt from taxation under section 501(c)(3) or 501(c)(6) of the Internal Revenue Code that administers, manages, or operates one or more evergreen funds, if at least one of those funds is organized to provide early-stage venture capital funding to entities within Michigan and has a principal office located in a county with a population of more than 600,000 and less than 700,000.³
- A Michigan nonprofit that administers, manages, or operates one or more evergreen funds, if that nonprofit is organized for the purpose of enhancing the vitality of the communities affected by Michigan’s Upper Peninsula by

¹ This provision appears to reference the Michigan State University Research Foundation.

² This provision appears to reference the Biosciences Research and Commercialization Center at Western Michigan University.

³ This provision would apply to a public institution of higher education or a nonprofit based in Kent County.

leveraging local resources with capital and expertise and fostering economic opportunity throughout the area.⁴

- A Michigan nonprofit that administers, manages, or operates one or more evergreen funds and grants, if that nonprofit is organized to provide early-stage venture capital funding to entities within Michigan and has a principal office located in a county with a population of more than 90,000 and less than 99,000.

Qualified start-up support services would mean any of the following:

- Activity that supports the growth of the state’s venture capital talent pool and the development of the next generation of venture capital fund leadership in Michigan.
- Activity that supports the creation and growth of Michigan start-up companies or that supports the professional development and growth of their founders.

Michigan Innovation Fund grants would be funded through money deposited into the 21st Century Jobs Trust Fund from the Michigan Early Stage Venture Investment Fund (as would be required by HB 5652). Each fiscal year through 2053-54, the MSF would use 80% of the money deposited into the 21st Century Jobs Trust Fund to provide grants to qualified evergreen venture funds for ***eligible activities***, 7% for grants to ***qualified nonprofits*** for qualified start-up support services, 8% for grants to qualified emerging evergreen funds for eligible activities, and 5% for transfer and deposit into the Jobs for Michigan Investment Fund for investments with the purpose of creating incentives for creating or retaining jobs, encouraging the development and commercialization of competitive edge technologies, and revitalizing Michigan communities. The MSF could not enter into any new grant agreements or make new commitments to recipients after December 31, 2054.

Eligible activity would mean an investment through an investment instrument (such as a convertible note, a simple agreement for future equity [SAFE], or an equity investment) in an early-stage start-up company located in Michigan that is engaged in one or more ***competitive edge technologies***, in addition to technical assistance related to such an investment and grants related to the investment or assistance.

Competitive edge technology is defined by the act as life sciences technology; advanced automotive, manufacturing, materials, information, and agricultural processing technology; homeland security and defense technology; alternative energy technology; or any other innovative technology as determined by the MSF board.

Qualified nonprofit would mean a nonprofit corporation that provides programming, technical assistance, or other support to promote the growth and development of the state’s start-up companies and their founders. It would include entities in Michigan that administer, manage, or operate funds that invest in start-up companies in Michigan.

The MSF would have to award grants to qualified evergreen venture funds and qualified emerging evergreen funds no later than 182 days after the money is deposited into the 21st Century Jobs Trust Fund. For all grants to those funds in a fiscal year, the total amount of grants

⁴ This provision appears to reference InvestUP.

provided to funds that invest in multiple industry sectors would have to be at least twice the total amount of grants provided to those that invest in only one sector.

Grant agreements

House Bill 5653 would authorize the MSF to enter into grant agreements to ensure that a qualified evergreen venture fund or qualified emerging evergreen fund complies with the bill's requirements. A grant agreement would have to require an award to be committed within five years after its receipt and would have to allow up to 15% of the award amount to be used for the recipient's administration of the award and technical assistance related to its investments (such as coaching, mentoring, and programming to support business founders).

Grant agreements would also have to require at least 15% of the grant money invested to be invested in *geographically disadvantaged business enterprises*, require the recipient to reinvest at least 85% of money invested with grant proceeds, , and require the recipient to notify the MSF within 90 days if there is a change in the recipient's senior leadership team.⁵

Geographically disadvantaged business enterprise would mean a person that is certified as a HUBZone small business concern by the United States Small Business Administration,⁶ has a principal place of business located within a qualified opportunity zone in Michigan,⁷ or for which more than half of its employees have a principal residence located within a qualified opportunity zone in Michigan.

An agreement would also have to require a recipient to provide an annual report on its activities by April 15, which would be published on the MSF website and the recipient's website.⁸ The report would generally have to summarize all administrative and operational costs incurred, including any professional fees and expenses, , provide the amount, date, and description of returns made from each investment made with grant proceeds, and provide a list of investments made with grant award proceeds during the immediately preceding calendar year that includes the following information:⁹

- The name and physical address of the recipient of each investment.
- The date and amount of each investment.
- A description of the type of investment and a description of the industry or economic sector in which the recipient operates.
- An indication of whether the investment is a new investment in the recipient or a follow-on investment.
- An indication of the number of jobs created, retained, or both as a result of the investment.

⁵ Within 90 days after the MSF is notified that there has been a change in the senior leadership team, the MSF would have to conduct a performance review of all investments made by the grant recipient and submit a report to the Senate and House appropriations subcommittees on general government, the Senate and House fiscal agencies, the Senate and House policy offices, and the State Budget Office on those investments that includes any considerations the MSF deems relevant regarding the change.

⁶ See: <https://maps.certify.sba.gov/hubzone/map#center=44.722800,-103.249700&zoom=4>.

⁷ See: <https://michigan.maps.arcgis.com/apps/webappviewer/index.html?id=8b1413d59b8d420faaf5217a5ab52851>.

⁸ The MSF would be responsible for prescribing a standard form for the report.

⁹ A recipient would not be required to report information that is exempt from disclosure under the Freedom of Information Act (FOIA).

Venture Capital Investment Program

Currently under the Venture Capital Investment Program, the MSF board can authorize investments in or alongside a qualified venture capital fund that invests primarily in early-stage businesses. The program coordinates with the Michigan Early Stage Venture Investment Fund to ensure that a continuum of venture capital is available in Michigan, and 80% of the funds allocated through the program must focus on competitive edge technologies. To be eligible to receive investments through the Venture Capital Investment Program, a qualified venture capital fund generally must operate a business development office in Michigan that is staffed with at least one full-time employee who is actively seeking opportunities for venture capital investments in Michigan businesses, unless the qualified venture capital fund requests an investment opportunity that is targeted to a specific transaction involving a competitive edge technology that will not occur without the MSF's investment.

House Bill 5653 would specify that the businesses receiving investments must be located in Michigan and would eliminate the competitive edge technology exception. The bill would also remove the provisions requiring the Venture Capital Investment Program to coordinate with the Michigan Early Stage Venture Investment Fund and designating 80% of the funds for investments in competitive edge technologies.

Additional provisions

By January 1, 2030, the MSF would have to conduct a formal review of the Michigan Innovation Fund program and submit a report on the program's performance and effectiveness to the Senate and House appropriations subcommittees on general government, the Senate and House fiscal agencies, the Senate and House policy offices, and the State Budget Office.

The MSF board could authorize money in the Jobs for Michigan Investment Fund from the Michigan Innovation Fund not invested as authorized under the act to be managed by the state treasurer as part of the common cash of the state, if the money is separately accounted for.

An officer of the MSF could establish restricted subaccounts within the Jobs for Michigan Investment Fund as necessary for administration of the fund.

The bill would amend other provisions of the act to require money deposited into the 21st Century Jobs Trust Fund to be expended as described above for the Michigan Innovation Fund program, allow the Jobs for Michigan Investment Fund to consist of money deposited under the Michigan Innovation Fund, and remove references to MSF funding for tourism promotion.

MCL 125.2088b et seq. and proposed MCL 125.2088u

House Bill 5651 would amend the Michigan Trust Fund Act to provide for the deposit of money from the Michigan Early Stage Venture Investment Fund (as would be required by HBs 5652 and 5623) into the 21st Century Jobs Trust Fund. Money deposited in the fund from these sources could only be transferred and disbursed for the purpose of the Michigan Innovation Fund program.

MCL 12.257 and 12.258

All three bills are tie-barred together, meaning that none of them can take effect unless all three bills are enacted.

HOUSE COMMITTEE ACTION:

The H-2 substitute reported from the House Economic Development and Small Business committee for HB 5653 allowed qualified emerging evergreen funds in the Grand Rapids area and Upper Peninsula to be eligible for grant funding, reduced the amount of a grant award that could be used for administrative expenses from 20% to 10%, and required 10% of the money from large long-term investment returns to be kept by the MSF for future grants.

HOUSE FLOOR ACTION:

The proposed H-5 substitute for House Bill 5653 amends the bill to do the following:

- Sunset the program after the 2053-2054 fiscal year.
- Reduce the distribution of money deposited into the 21st Century Jobs Trust Fund to qualified nonprofits from 12% to 7% and require 5% of the to be used for investments through the Jobs for Michigan Investment Fund.
- Remove a provision that would have modified the distribution of funds in fiscal years after 2024-25. (The H-3 version of the bill proposed distributing 60% of the funds to evergreen venture funds and emerging evergreen funds, 20% for deposit in the Jobs for Michigan Investment Fund, and 20% to qualified nonprofits after the 2024-25 fiscal year.)
- Increase the amount of a grant that can be spent on administration and technical assistance from 10% to 15%.
- Require grant recipients to reinvest at least 85% of returns on an ongoing basis, invest at least 15% of grant money into geographically disadvantaged business enterprises, describe investment returns in their annual report, and notify the MSF of any changes to their senior leadership team.
- Require, rather than allow, grant agreements to require participants to provide an annual report on its activities, which would have to be posted on the MSF and recipient's websites.
- Require the MSF to conduct a formal review of the program.
- Include a Michigan nonprofit that administers, manages, or operates evergreen funds and grants, is organized to provide early-stage venture capital funding to entities in Michigan, and has a principal office located in a county with a population between 90,000 and 99,000 under the definition of a qualified emerging evergreen fund.
- No longer require recipients to repay a percentage of returns if an investment results in a return of at least \$5.0 million in 15 years.
- Provide that the Michigan Innovation Fund and other 21st Century Jobs programs are to be operated and administered by the MSF and MEDC.
- Remove a provision that would have included activities to support the creation, development, and administration of Tech Hubs in the definition of qualified start-up support services eligible for grant funding.

The proposed H-2 substitute for House Bill 5652 amends the bill to do the following:

- Require a \$60.0 million distribution into the 21st Century Jobs Trust fund, with the remainder going to the general fund, if the MESVIC has one or more investment funds with realized earned returns of any amount as of June 30, 2024, and provide that any future earned returns must be deposited into the general fund. (A previous version of the bill required \$105.0 million to be distributed to the 21st Century Jobs Trust Fund if

the MESVIC had returns on investment funds that exceed that amount as of June 30, 2024, and required at least 75% of returns to be deposited into the 21st Century Jobs Trust Fund each following year if the MESVC had returns over \$10.0 million.)

- Require, upon dissolution, money and property held by the MESVIC to be deposited in the general fund rather than the 21st Century Jobs Fund.

ARGUMENTS:

For:

Supporters argue that the bills would address the lack of a thriving start-up culture in Michigan by providing funding to established organizations that have expertise in venture capital investing. They believe that taking action to develop the state's venture capital sector would catalyze broader economic development, since those investments would attract additional investment from around the country.

Neutral:

No arguments opposing the bills were presented during committee testimony, but concerns were raised about provisions that would allow only nonprofit fund investors to have access to the first round of funding through the program, since for-profit funds would be excluded despite sharing the goal of supporting Michigan's startup businesses.

Response:

Supporters of the legislation respond that the high-risk nature of early-stage investments make nonprofit firms the best option to take on that risk, since they can absorb lower returns than a for-profit investor while being able to continue investing. They add that due to Michigan's lack of early-stage capital, many smaller for-profit firms are currently unable to provide the funding that companies need to scale their businesses.

FISCAL INFORMATION:

The bills would authorize realized investment returns in investment funds of the Michigan Early State Venture Investment program to be utilized earlier than they otherwise would have been under current law. Current law would not release the funds until January 1, 2030, with \$140.0 million deposited in the general fund and the remainder deposited in the 21st Century Jobs Trust Fund. Available funds would be deposited in the 21st Century Jobs Trust Fund for a newly created Michigan Innovation Fund program that would support evergreen venture funds, venture capital funds, emerging evergreen funds, and qualified support services. Any remaining realized earned returns would be deposited in the state general fund.

For FY 2024-25, \$60.0 million of any realized earned returns would be deposited into 21st Century Jobs Trust Fund and the remainder of the earned returns would be deposited in the state general fund. It is currently estimated that there is approximately \$125.0 million of realized earned returns, which would indicate a general fund deposit of approximately \$65.0 million.

In subsequent years, if, on June 30 of that year, if there are realized earned returns in one or more investment funds the earned returns must be deposited in the state general fund. For FY 2025-26 and beyond, it cannot be determined with any certainty how much would be available for deposit in the state general fund.

Upon expiration of the Michigan Early Stage Venture Investment Program and associated funds on January 1, 2030 any funds remaining would be deposited in the state general fund under the bill. Under current law, the first \$140.0 million would be deposited in the state general fund with any remaining amount deposited in the 21st Century Jobs Trust Fund. Presumably, the provisions included in the bill that would require deposit of any annual realized earned returns into the state general fund beginning in FY 2025-26 would limit that amount available on January 1, 2030.

Under the Michigan Innovation Fund program, funds available for the Michigan Innovation Fund program would be available for expenditure through FY 2053-54.

Funds deposited in the 21st Century Jobs Trust Fund are subject to appropriation by the legislature for the purposes prescribed in the Michigan Innovation Fund program (described in detail above).

[NOTE: The FY 2024-25 appropriation act, 2024 PA 121, included \$60.0 million to be deposited in a Michigan Innovation Fund from the 21st Century Jobs Trust Fund to support a new Michigan Innovation Fund program that would support young startups in Michigan].

POSITIONS:

Representatives of the following entities testified in support of the bills (5-14-24):

- Ann Arbor Spark
- Automation Workz
- Clara Technologies
- Invest Detroit
- Michigan Black Business Alliance
- Michigan Venture Capital Association

The following entities indicated support for the bills:

- Alerje, Inc. (5-14-24)
- aLlight Sciences (5-14-24)
- Arcascope (5-14-24)
- Ashling Partners (5-14-24)
- Auricle, Inc. (5-14-24)
- Bioscience Navigators (5-14-24)
- BlueConduit (5-14-24)
- Brightwater Tools (5-14-24)
- Center Electric (5-14-24)
- City of Detroit (5-14-24)
- Cogrounded (5-14-24)
- CubeWorks (5-14-24)
- Decimal Code (5-14-24)
- Detroit Regional Chamber (5-14-24)
- Eberg Capital (5-14-24)
- Economic Development Leaders for Michigan (6-4-24)
- Ecovia Renewables (5-14-24)

- 86 Repairs (5-14-24)
- Farmish (5-14-24)
- Fifth Eye (5-14-24)
- First Ignite (5-14-24)
- Fusion Coolant Systems (5-14-24)
- GreenMark Biomedical (5-14-24)
- Grounded RVs (5-14-24)
- HealthBar (5-14-24)
- Housing North (6-4-24)
- Iaso Therapeutics (5-14-24)
- iReprogram (5-14-24)
- Kall Morris (5-14-24)
- M3D (5-14-24)
- Michigan Central (5-14-24)
- Michigan Regional Council of Carpenters and Millwrights (6-4-24)
- Middle Third (5-14-24)
- MediCool Technologies (5-14-24)
- MemryX (5-14-24)
- Mercury Fund (5-14-24)
- Michigan State University Research Foundation (5-14-24)
- Michigan Translational Research & Commercialization (5-14-24)
- Motion Grazer AI (5-14-24)
- Motivation, Inc. (5-14-24)
- Mountain Pass Solutions (5-14-24)
- Movellus (5-14-24)
- New Enterprise Forum (5-14-24)
- NewHaptics (5-14-24)
- NX Fuels (5-14-24)
- On It Solutions (5-14-24)
- 100k Ideas (5-14-24)
- Opnr (5-14-24)
- Pearl Edison (5-14-24)
- PhotosynQ (5-14-24)
- PlayBooked (5-14-24)
- Poás Bioenergy (5-14-24)
- Quantitative Collectors Group (5-14-24)
- Red Cedar Ventures (5-14-24)
- Refraction AI (5-14-24)
- Ripple Science (5-14-24)
- Spartan Innovations (5-14-24)
- Student Achievement Systems (5-14-24)
- Tandem (5-14-24)
- Taza Aya (5-14-24)
- Tech Stars (5-14-24)
- TechTown Detroit (5-14-24)
- The Patient Company (5-14-24)

- TheraB Medical Products (5-14-24)
- Ulendo Technologies (5-14-24)
- University of Michigan (5-14-24)
- Upkara (5-14-24)
- Venture Catalysts (5-14-24)
- Viewpoint (5-14-24)
- Washtenaw County Commission (6-4-24)
- Western Michigan University (5-14-24)
- Western Michigan University Biosciences Research and Commercialization Center (5-14-24)
- Workit Health (5-14-24)

A representative of Union Heritage testified with a neutral position on the bills. (5-14-24)

The Mackinac Center for Public Policy indicated opposition to the bills. (5-14-24)

Legislative Analyst: Holly Kuhn
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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations and does not constitute an official statement of legislative intent.